

AMERICAN BANKRUPTCY INSTITUTE JOURNAL

Issues and Information for the Insolvency Professional

Ten Principles of BAPCPA: Not What Was Advertised

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In the eight-year run-up to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), the coalition of consumer lenders driving this legislation won the public relations war for bankruptcy reform. With sometimes arrogant disregard for the facts about debt and debtors in bankruptcy,¹ lobbyists and executives for the consumer credit industry convinced Congress that abuse was rampant in bankruptcy, that many debtors were using bankruptcy as a “first resort” to avoid paying creditors, and that courts weren’t doing enough to police the bankruptcy system.²



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Ironically, the disconnect between the realities of bankruptcy and what the credit industry representatives told Congress extended to the resulting legislation itself. Had the members of the credit coalition read their own legislation, they would have discovered that BAPCPA does not deliver much of what their lobbyists claimed, but it does deliver much that they are not expecting.

For those inclined to look for the forest before drilling into the details of this new law, here are 10 principles of BAPCPA.

One: Those Who Can Pay Should Pay

Bruce Mann, in his wonderful account of bankruptcy in America during the early years of the republic,³ recounts the ambivalence of the founders with respect to whether economic failure equates to a failure of character. Through more than two centuries of ever-increasing commercialization of borrowing and lending, there have been periods in our bankruptcy history when debt was relatively demoralized—these periods characterized by less retribution in the handling of debtors by the legal system—and periods of “remoralization” like the one that birthed BAPCPA.

As quoted in the House Judiciary Committee Report that accompanies BAPCPA: “Shoplifting is wrong; bankruptcy is also a moral act. Bankruptcy is a moral as well as an economic act. There is a conscious decision not to keep one’s promises.”⁴ No matter that debtors in bankruptcy are worse off economically than they were 20 years ago—the “explosive” growth of bankruptcy filings demonstrates that un-needy, bad people are flocking to our bankruptcy courts. No matter that most debtors in bankruptcy are broke because of job loss, health problems or a failed business—bankruptcy should be a squeeze that hurts. The “make ‘em pay” principle manifests itself in BAPCPA in three major areas: A new “abuse” test (the so-called “means” test) to get into chapter 7, many new exceptions to discharge and caps on exemptions.

The admissions test for chapter 7 (the abuse test in §707(b)) will make debtors pay more—to their lawyers. There is a lot of new paperwork and several obscure new calculations. Higher attorney fees and delays in processing chapter 7 cases are inevitable.

But first, who came up with the idea that sifting for a few “abusive” chapter 7 cases will cause debtors to pay their creditors? The abuse test in §707(b) or, more likely, the additional expense of dealing with it (see below) may deter some debtors. What

portion of those denied chapter 7 relief will pay their creditors? How many will disappear? Is there any return to creditors for the millions of dollars that millions of potential debtors will pay to run the §707(b) gauntlet?

And take a look at how BAPCPA turns the abuse test on its head in chapter 13 cases. In §1325(b), BAPCPA substitutes the abuse test from §707(b) for the “reasonably necessary” test to determine disposable income with respect to over-median-income debtors. Because contractually scheduled secured debt payments automatically become reasonable and necessary expenses under the abuse test, BAPCPA will generate less money for unsecured creditors in chapter 13 cases. Perversely, this use of the abuse test in chapter 13 cases makes the wealthiest debtors pay less than under existing law.

There are many new §523 exceptions to discharge in BAPCPA, but no lobbyist or lender representative offered any evidence that enlarging the class of nondischargeable consumer debts makes those pay who can pay. Is there an undocumented correlation between ability to pay and nondischargeable debt? More likely, the proliferation of nondischargeable debt is punishment, not debt collection.

This suspicion is confirmed elsewhere in BAPCPA. Many of the new exceptions to discharge were added to §1328(a). Increasing the debt that is nondischargeable in a chapter 13 case removes a major incentive for debtors to file chapter 13 rather than chapter 7. This is not what the proponents of BAPCPA promised.⁵ There is no dispute that more debt gets paid through chapter 13 cases than by distributions in chapter 7 cases.⁶ Barring the door to chapter 7 with an abuse test, then neutering the chapter 13 alternative with exceptions to discharge, will not increase what creditors get from debtors or limit bankruptcy relief to those who are neediest.

The new domiciliary rules and caps on exemptions in BAPCPA were advertised

¹ One of the most blatant misrepresentations was the sound bite that “bankruptcy costs every American family \$400 each year.” This fabrication was the brain child of a lobbyist for the credit coalition named Jeff Tassey. The claim gained credence when it was repeated in paid advertisements and by congressmen. The provenance of this prevarication is detailed in Warren, Elizabeth, “The Market for Data: The Changing Role of Social Sciences in Shaping the Law,” 2002 Wis. L. Rev. 1.

² See H.R. Rep. No. 109-31 Pt.1, at 5-8 (2005).

³ Mann, Bruce H., *Republic of Debtors* (Harvard Univ. Press, 2002).

⁴ H.R. Rep. No. 109-31 at 3-4 n.1.

⁵ H.R. Rep. No. 109-31 at 18. (“[I]f needs-based reforms and other measures were implemented, the rate of repayment to creditors would increase as more debtors were shifted into chapter 13”).

⁶ Flynn, Ed, Bernant, Gordon and Bakewell, Karen, “A Tale of Two Chapters” (“[T]he amount of money collected by trustees and disbursed to creditors in chapter 13 cases is much higher than the amount collected in chapter 7 cases”), 10 *ABI Journal* 20 (2002), available at www.usdoj.gov/ustpress/articles/abi82002.htm.

parts of the make 'em pay strategy. The new exemption rules are so poorly drafted they may actually increase exemptions for many debtors by making federal exemptions available notwithstanding that the state of the debtor's current residence has opted out of the federal exemptions.⁷ This will reduce the assets available for distribution to creditors in many bankruptcy cases.

The new exemption caps affect only a few states that have homestead exemptions in excess of \$125,000, and then only recent homesteaders who have elected state exemptions. An exemption cap that applies only in bankruptcy could convince a few folks not to file bankruptcy in order to retain the *higher* exemptions available under state law. Limiting the exemptions available in bankruptcy may encourage *involuntary* bankruptcies in states with larger homestead exemptions. Twisted irony, this is: Encourage debtors not to file bankruptcy so they can keep more exempt property from their creditors; increase (involuntary) bankruptcy filings to make those pay who can pay.

Two: Don't Trust Debtors

This might be called the Larry Friedman Legacy. Larry was the director of the Executive Office of the U.S. Trustee from March 4, 2002, to April 27, 2005. In a prior life, Larry was a chapter 7 panel trustee in Michigan. Larry will tell you that one of his favorite tricks as a trustee was to show up at a debtor's home with a video camera to record the inside for comparison with the personal property schedule. Larry says he learned to distrust the statements and schedules in chapter 7 cases.

That distrust was an easy sell in the anti-debtor environment ginned up by the credit coalition. As the House Report recites repetitiously, there is abuse in bankruptcy cases including that debtors don't tell the truth about their assets, income, etc.

There are many new filings and duties requiring consumer debtors to document information already required under penalty of perjury by the Statement and Schedules. Debtors now must provide⁸ or file 60 days of "payment advices,"⁹ one, three, four or more years of tax returns¹⁰ and several new certificates,¹¹ and the pile of new documents is subject to random audits by the Justice Department.¹² Multiple swearings by the debtor was just not enough; now debtor's counsel also has to certify the schedules in chapter 7 cases.¹³ There are new Miranda-

like notices and warnings to debtors that inaccuracies in bankruptcy papers constitute a criminal offense.¹⁴

Bankruptcy trustees, especially chapter 13 trustees, are scratching their heads about what they are going to do with the mounds of paper required of debtors by BAPCPA. There is no new money for trustees in BAPCPA. Apparently, case trustees are supposed to review and police the new filings, advices, certificates and tax returns because they love their jobs. The U.S. Trustee gets more money from the increased filing fees in chapter 7 cases.¹⁵ Maybe the Friedman Legacy will play out in an increased role for the agency he left.

Can creditors expect a greater return in bankruptcy cases as a result of the new filings and duties imposed on debtors? Will creditors spend the money to demand and review tax returns or to compare payment advices to Schedules I and J? Will the threat of random audits by the U.S. Trustee increase bankruptcy dividends to unsecured creditors? Two things are certain: The answers to these questions are not clear, but the new filings and duties are imposed on every one of the millions of individuals who will pass through the bankruptcy system after Oct. 17. There will be a good study here for an empirically inclined bankruptcy scholar in a year or two. I bet that creditors would be better off with a *pro rata* distribution of the cost of the new filing cabinets that trustees will buy to maintain (securely!) the millions of tax returns required by BAPCPA.

Three: Don't Trust Judges

As Jeff Tasse, a lobbyist for the credit coalition put it, "they're part of the...problem... They're not real judges."¹⁶ Together with anti-debtor (see above) and anti-lawyer (see below) themes, BAPCPA arrived on a wave of anti-bankruptcy judge rhetoric.

As if blaming the court system for too many people with debt trouble, BAPCPA is packed with provisions intended to "reduce the discretion" of bankruptcy judges. The self-proclaimed backbone of BAPCPA—the abuse test in §707(b)—purports to be a mindless mathematical formula with fill-in-the-blank numbers and presumptions. If debtors fail to file required documents or fail to perform certain duties, bankruptcy cases are now dismissed "automatically"—without judicial interference and without court order.¹⁷ The "reasonable and neces-

sary" standard for expenses for over-median-income chapter 13 debtors is replaced with the mathematical test for abuse in §707(b).¹⁸

Be careful what you ask for. The abuse test in §707(b) rewards and grotesquely underestimates the ingenuity and resourcefulness of bankruptcy lawyers and their clients. Did any credit union member or banker actually look at the categories and allowances in the *IRS Manual* before their lobbyists passed on the laundry list of deductions in new §707(b)(2)? Substituting IRS guidelines for "(substantial) abuse" will not be an effective gatekeeper for access to chapter 7.

Are creditors willing to risk that an (invisible) "automatic" dismissal is not quite as dismissed as a dismissal ordered by one of those loathsome bankruptcy judges? Are unsecured creditors better off with a formula that bases distributions in over-median-income chapter 13 cases on deductions of contractually scheduled payments to secured creditors without regard to reasonableness or necessity? No way.

Of course, (substantial) abuse does not mean exactly the same thing to every bankruptcy judge. Reasonable and necessary expenses will not reduce to certainty across all districts and all chapter 13 cases. But it is surely true that hundreds of appellate decisions in consumer bankruptcy cases over 25 years of the Code have substantially narrowed the exercise of discretion by bankruptcy judges in many of the areas that BAPCPA attacks with formulas and automation.

It is easy to predict that the credit community will complain "that's not what we meant" each time a bankruptcy judge refuses to exercise discretion and instead applies the math exactly as it appears in new §707(b) or §1325(b). You can bet the lobbyists who delivered BAPCPA will be the first to claim it is the bankruptcy (non)judges who are impeding and distorting all their good work.

Four: Don't Trust Lawyers

Without a shred of evidence, BAPCPA convicts debtors' attorneys as conspirators in an "abusive" bankruptcy system. In chapter 7 cases, there is a new certification that the debtor's attorney "has no knowledge after an inquiry that the information on the schedules...is incorrect."¹⁹ The signature of debtor's counsel certifies that the petition "does not constitute an abuse" based on a "reasonable investigation."²⁰

Punitively, BAPCPA de-professionalizes bankruptcy attorneys as "debt relief

⁷ See 11 U.S.C. §522(b).

⁸ See, e.g., 11 U.S.C. §521(e)(2)(A) ("The debtor shall *provide*...") (emphasis added).

⁹ See 11 U.S.C. §521(a)(1)(B)(iv).

¹⁰ 11 U.S.C. §§521(e), 521(f), 521(j), 1307(e) and 1308.

¹¹ See 11 U.S.C. §§109(h), 362(l), 521(b), 521(c) and 1328(a).

¹² 28 U.S.C. §586(f).

¹³ 11 U.S.C. §707(b)(4)(D).

¹⁴ 11 U.S.C. §527(a)(2).

¹⁵ See Emergency Supplemental Appropriations Act for Defense, the Global War on Terror and Tsunami Relief 2005, Pub. L. No. 109-13, 119 Stat. 231 (2005).

¹⁶ Gosselin, Peter G., "Judges Say Overhaul Would Weaken Bankruptcy System," *Los Angeles Times*, Mar. 29, 2005, available at www.latimes.com/news/nationworld/nation/la-na-bankrupt29mar29.1.20503816.story?coll=la-headlines-nation.

¹⁷ See 11 U.S.C. §521(i).

¹⁸ 11 U.S.C. §1325(b).

¹⁹ 11 U.S.C. §707(b)(4)(D).

²⁰ 11 U.S.C. §707(b)(4)(C).

agencies.”²¹ Sections 526, 527 and 528 require debt relief agencies to give notices and warnings that are not relevant in many of the circumstances in which they must be given, that will be false in some required contexts and that are just mean and scary for no obvious benefit. While heaping innumerable new complexities onto bankruptcy law, BAPCPA requires debtors’ attorneys to tell potential clients that they can represent themselves or seek “help” from a bankruptcy petition preparer who is forbidden to give legal advice. New §528 requires some attorneys to advertise that they “help people file for bankruptcy relief” even when they don’t. In addition to bar disciplinary boards, attorneys who are debt relief agencies will be subject to oversight by state consumer protection agencies.

This is new territory—a federal statute that regulates the contracting practices and advice given by state-licensed attorneys in a single subject-matter area. There are no federal statutes imposing comparable duties or restrictions on tax lawyers or antitrust lawyers or on plaintiffs’ counsel in securities litigation. The “abuse” at which these attorney provisions are aimed is not identified in the eight years of legislative materials produced by the proponents of BAPCPA. The new attorney liability risks in BAPCPA are likely to raise costs for bankruptcy attorneys and may well drive some out of the practice. Burdening the content of advertising by attorneys who practice in the bankruptcy courts could reduce the availability of legal services in bankruptcy cases. Perhaps that was the goal—make it harder for debtors to find competent lawyers.

Five: Make the Door Smaller

Especially for consumer debtors, BAPCPA reduces access to bankruptcy relief by making bankruptcy more costly, more complicated and less efficient. Add up all of the new documents, the new certificates, the new deadlines, the new hearings, the new obstacles to chapter 7 entry and to chapter 13 confirmation—BAPCPA requires a lot more work for debtors’ attorneys. Debtors will pay for that work, and some debtors will simply be priced out of bankruptcy. All consumer bankruptcy cases are going to be more complicated and will move more slowly than they do now.

Why did Congress make the door to the bankruptcy court smaller? If a few potential debtors are dissuaded from filing bankruptcy, where will they go? Are these the less-needy debtors who will pay their creditors rather than file bankruptcy? Don’t

bet on it. We will wait a long time for empirical evidence that making bankruptcy more costly and complicated is good for somebody.

Don’t think for a minute that bankruptcy professionals are happy about this purposeless complication and inefficiency. Getting paid to gather paycheck stubs or to certify worthless sticks of furniture has no utility for anyone in bankruptcy cases.

Six: The Rich Fare Better than the Poor

Anyone who drills into BAPCPA can’t help but be astonished by how often wealthier debtors get better treatment than less-wealthy debtors. Maybe it’s the million-dollar “cap” on the exemption of IRAs—which can be more than a million if the bankruptcy court exercises vestigial discretion to enlarge the exemption.²² For over-median-income debtors, the mathematical formula that determines access to chapter 7 and allowable expenses in chapter 13 automatically accepts the contractual amount scheduled with respect to all secured debts.²³ Who writes a bankruptcy law that favors debtors with expensive homes and luxury items with access to chapter 7? The credit coalition lobbyists sold Congress on the notion that wealthier debtors in bankruptcy should decide for themselves what secured debts are reasonable and necessary.

Why are homeowners almost always better off than apartment-renters under BAPCPA? Is it good policy that debtors with higher incomes eat more food and buy more clothes than debtors with lower incomes? Why do we punish debtors’ attorneys with special advertising rules only when they counsel debtors with *less than* \$150,000 of non-exempt assets? Do attorneys who counsel wealthy debtors need less oversight than attorneys who counsel really poor people?

Seven: Unsecured Creditors Don’t Count

The powerful coalition of lenders that assembled in 1997 to push bankruptcy reform took advantage of its own less-powerful members. Somewhere around 2002, the car lenders turned on the “Great Unwashed” and the outcome is that unsecured creditors were a lot better off under the former Bankruptcy Code than they will be under BAPCPA.

If you don’t believe it, take a quick look at §§506, 1325(a)(5) and 1325(b). Three or four hundred thousand cars are crammed-down each year in chapter 13 cases.

Multiply that number by the typical unsecured claim that cram-down produces. The resulting amount is north of \$1 billion a year that used to be available for distribution to other creditors in chapter 13 cases. After BAPCPA, that money stays with the car lenders and it comes right out of the pockets of the hospitals and credit card companies that sat at the same table all those years. No tears here, just wonder at the lack of honor among members of the coalition. Perhaps this was a conscious choice by some parts of the coalition to pass BAPCPA at all costs.

Then there are new preconfirmation direct payment requirements to secured claim-holders in §1326, perfection changes in the defenses to preference recovery in §547 and assets that invisibly leave the bankruptcy estate in §521—lots of little changes that improve the position of secured claim-holders in bankruptcy cases. The money has to come from someplace. You can bet that distributions to unsecured creditors in consumer bankruptcy cases will go down under BAPCPA. As Prof. Mann put it, “honor is no substitute for a good security interest.”²⁴

Eight: Debtors Must Beg for Relief

Most of the fundamental debtor protections in existing bankruptcy law are self-starting and are lost only upon some action by a creditor. The automatic stay is truly automatic—effective everywhere with respect to everyone without a motion from the debtor or court order. Relief from the stay requires a motion, hearing and order. If a debtor misbehaves in a bankruptcy case, a party in interest makes a motion to dismiss, the court holds a hearing and, if the evidence holds up, a dismissal order ends the case.

BAPCPA is different. Some consumer debtors will have to ask for relief that used to be automatic, and bad things will happen to debtors in bankruptcy cases unless debtors act to stop them. Debtors with prior bankruptcy experience will have no stay unless they ask for it²⁵ or will have a 30-day stay that they must act to extend.²⁶ There will be automatic dismissals when certain things happen or don’t happen in consumer bankruptcy cases.²⁷ Debtors must act on a strict time schedule to interrupt an automatic dismissal.²⁸

Debtors aren’t the only victims of burden-shifting in BAPCPA. Chapter 7 trustees will have to act quickly to stop assets with value for unsecured creditors from leaving the bankruptcy estate and disappearing into the hands of defectively secured creditors.²⁹

²⁴ Mann, Bruce H., *Republic of Debtors* 260 (Harvard Univ. Press, 2002).

²⁵ 11 U.S.C. §362(c)(4).

²⁶ 11 U.S.C. §362(c)(3).

²⁷ See §521(i).

²⁸ See §521(i)(3) and (4).

²¹ 11 U.S.C. §101(12A).

²² See 11 U.S.C. §522(m).

²³ 11 U.S.C. §§707(b) and 1325(b).

Nine: Malice or Incompetence?

You could call this the “we don’t trust experts” principle. The list of drafting errors and incomprehensible provisions grows every day as bankruptcy professionals digest BAPCPA. Especially the consumer parts, this legislation was not written or vetted by the practitioners and scholars usually involved in bankruptcy legislative efforts.

Some of the mistakes are almost too bizarre to have been intentional. Did the lobbyists who wrote BAPCPA intend to make federal exemptions available to thousands of debtors in states that have opted out of the federal exemptions?²⁹ After highly publicized battles in the past, did someone in D.C. intentionally revoke the 15 percent charitable deduction for over-median-income chapter 13 debtors?³¹ Did Congress intend to invalidate all state exemption laws with respect to the collection of domestic support obligations?³²

Whether by design or default, bankruptcy practitioners and judges will spend decades unraveling cross-references that lead nowhere and interpreting new terms of art that fail to communicate.³³ If the drafters intended to make bankruptcy more complicated and expensive by making the bankruptcy law less coherent and more difficult of application, they succeeded. There will be generations of “technical amendments.”

Perhaps the most important next question is whether competent bankruptcy professionals will get involved to “fix” BAPCPA. Don’t forget: The folks who wrote BAPCPA told Congress this law was perfect.³⁴

Ten: The Former Law Is Still There

In 1978, Congress scrapped the former Bankruptcy Act and enacted a whole new Code. BAPCPA rides in a sidecar to the existing Code. Almost all of the old Code still applies to some or all debtors. The rules and tests that the credit community told Congress gave bankruptcy judges too much discretion and allowed too many debtors to escape without paying still apply to some, even many, debtors.

For example, even after BAPCPA, with respect to under-median-income chapter 13 debtors, bankruptcy judges review for reasonableness and necessity debtor choices about how much to spend for a car, a house or a waterbed. Pre-BAPCPA decisions interpreting disposable income in §1325(b) remain

²⁹ See hanging paragraph after §521(a)(6)(B).

³⁰ See 11 U.S.C. §522(b).

³¹ See §1325(b).

³² See §522(c)(1).

³³ See, e.g., 11 U.S.C. §342(g)(1) (“brought to the attention”).

³⁴ S.256 Hearings Before Senate Judiciary Committee, Feb. 10, 2005.

relevant to some bankruptcy cases. Poorer debtors remain subject to the old law; richer debtors have a new test that lets them decide how much to spend on a car or a house. This is the new world of BAPCPA.

Don’t throw away those seminar materials and previous editions. The cases interpreting key concepts in consumer bankruptcy practice remain vital for the most part. There will be parallel concepts, cases and secondary interpretations as BAPCPA is implemented after Oct. 17, 2005.

Conclusion

For 25 years, we have worked with a bankruptcy law that was substantially consistent in its implementation of familiar principles and even elegant in its technical construction. BAPCPA is fundamentally different in both respects: the drum beats of its proponents are not carried into the score and the nomenclature of this law is obscure and often incomprehensible. What should bankruptcy practitioners and judges do as we embark on implementation of BAPCPA? Here are some suggestions:

1. *Don’t let anyone tell you what BAPCPA says; read it for yourself.* In and out of court you are going to hear a lot about what BAPCPA says. Don’t believe it. There is no substitute for reading it yourself and drawing your own conclusions. What “they” may have meant to say and what they actually said are different things in many places that matter. We no longer have the luxury of relying on thousands of reported cases and secondary authorities. We have to start over at that diabolical place law professors tell us to go when all else fails: Read the statute.

2. *Every word counts.* This is what **Hank Hildebrand**, the chapter 13 trustee in Nashville, Tenn., calls “the Easter egg phenomenon.” Every time you read a piece of BAPCPA, the words are going to tell you something new or different. Every word has to mean something and there are so many new terms of art and new concepts in BAPCPA that no one can take big bites. Instead, take it one word at a time and let every word mean what it says. The Easter eggs will roll out just by paying careful attention to the words.

3. *“Plain meaning” is the starting point.* Resist the temptation to jump from reading the words to divining intent. Sure there is legislative history—some would say there is eight years of it beginning with the Responsible Borrower Protection Bankruptcy Act of 1997.³⁵ But much was lost, much changed and much was added in the

³⁵ H.R. 2500, 105th Cong., 1st Sess. (1997).

translation of rhetoric into BAPCPA. It will often be in the best interests of one player or another to skip the devil and start with what “they” intended. The Supremes have repeatedly admonished the bankruptcy community to start with the words of the statute³⁶—and that’s where it all begins in October. ■

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³⁶ *Patterson v. Shumate*, 504 U.S. 753, 760, 112 S.Ct. 2242, 2248, 119 L.Ed. 2d 519 (1992) (“exceptionally heavy burden” to defeat plain meaning of Bankruptcy Code); *Union Bank v. Wolas*, 502 U.S. 151, 158, 112 S.Ct. 527, 531, 116 L. Ed. 2d 514 (1991) (“The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning”).